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The Institute of Chartered Accountants in Australia, the National Institute of Accountants, The Taxation Institute of Australia, CPA Australia and Taxpayers Australia

Draft Wine Equalisation Tax Determination WETD 2009/D1

Wine Equalisation Tax:
What are the results for Wine Equalisation Tax purposes for entities engaging in an arrangement described in Taxpayer Alert TA 2009/6?

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The professional bodies welcome the opportunity to comment on draft WET determination WETD 2009/D1. It is not often that our comments on draft indirect tax rulings and determinations are completely unsupportive. This, however, is one such occasion.

The general anti-avoidance provision ("GAP") can be found in Division 165 of the A New Tax System (Goods and Services Tax) Act 1999 ("the GST Act"). Its operation is extended to the A New Tax System (Wine Equalisation Tax) Act 1999 ("the WET Act") by sections 21-1 and 23-10 of the WET Act.

The objective of the WET Act is described in WETR 2009/1:
45. The broad aim of the WET Act is to impose wine tax on dealings with wine in Australia. Dealings which attract wine tax are called assessable dealings and can include selling wine, using wine, or making a local entry of imported wine at the customs barrier.
46. The wine tax is normally a once only tax designed to fall on the last wholesale sale. Where wine is sold by wholesale to a retailer, for example, to a distributor, bottle shop, hotel or restaurant, wine tax is calculated on the selling price of the wine (excluding wine tax and GST).[14] If wine is not the subject of a wholesale sale, for example, it is sold by retail by the manufacturer at the cellar door or used by the manufacturer for tastings or promotional activities, alternative values are used to calculate the tax payable.
47. Wine tax is imposed on assessable dealings with wine, unless an exemption applies. If the dealing is taxable, wine tax is calculated on the taxable value of the dealing. If the wine, or some part of the wine, has already been subject to a taxable dealing,[15] then a credit for that earlier tax may be claimed as an offset against the tax payable on the later dealing.

Executive Summary

The professional bodies are particularly concerned by the approach adopted in the draft determination, as it proposes action being been taken against parties, who are neither beneficiaries of, nor participants in, a scheme to avoid WET and would encourage the Commissioner to rethink the position. In this respect, we wish to record our strong opposition to the basis on which the draft determination proceeds.

As a general principle, the adoption of commercial arrangements, which are recognised by and provided for in the GST and/or WET Acts, should not be the subject of compliance action under GAP. The mere fact that a taxpayer chooses to adopt one form of commercial arrangement instead of another, or to change from one form of arrangement to another, should not be regarded as an indirect tax avoidance scheme.

The Institute notes that the indirect marketing provision is itself a de facto specific anti-avoidance provision, and queries why a general anti-avoidance provision would ever be needed to override the specific anti-avoidance provision.

If the behavior is to be regarded as a scheme under the GAP, the Commissioner should publish clear guidelines on what is involved in an indirect tax scheme, so that taxpayers will be in a position to structure their commercial arrangements in full knowledge of the Commissioner's likely attitude about particular arrangements.

It is the view of the professional bodies that in dealings involving GST and/or WET, a contrived artificial or unnecessary step or feature should be present before the GAP will be considered.

If the GAP is to be used, the professional bodies also consider that it should be used to challenge participants in an alleged scheme, not third parties.

The professional bodies consider that if this outcome cannot be achieved based on the current law, then a legislative change would be preferable to the approach reflected in the draft determination.

DRAFT DETERMINATION WETD 2009/D1

The draft determination identifies a particular scheme involving the retail sale of wine by a marketer through a retailer acting as the marketer's selling agent. These arrangements are described and provided for in the WET Act as indirect marketing sales, see for example section 5-20, and where they occur the WET Act provides for WET to be calculated and paid on a taxable value equal to the notional wholesale selling price. One of the values available for this purpose is half the retail selling price of the wine. This value is described in section 9-25 of the WET Act as the half retail price method.

Before indirect marketing arrangements were introduced, the retailer would purchase wine WET-paid from wholesale suppliers who are typically wine producers and distributors unrelated to the retailer. WET would be paid on the wholesale selling price charged by each supplier. After implementing indirect marketing arrangements, the marketer purchases the wine from the supplier WET-free and pays WET on half the retail price, in accordance with the provisions of the WET Act.

According to the draft determination, the WET intended to be payable under the legislative scheme is reduced by the adoption of indirect marketing. The amount of the reduction is the difference between the WET formerly charged on the supplier's wholesale price and the WET calculated on the half retail price method and paid by the marketer.

However, instead of challenging the marketer and/or the retailer for avoiding WET, the draft determination proposes at paragraphs 17 to 19 a possible action against the suppliers for the whole amount of WET payable. Despite the marketer having paid WET calculated on half the retail price, it appears that the supplier may be required to pay the full WET amount.

GENERAL COMMENTS

The professional bodies strongly oppose the approach taken in the draft determination, believing it to be an unwarranted strike at unrelated third parties, who are neither beneficiaries of, nor participants in, a scheme to avoid WET.

For many years under the WET Act and its predecessor, the wholesale sales tax legislation, the Commissioner has accepted that taxpayers can structure their commercial arrangements,

including their conditions of sale, so as to legitimately reduce or defer the amount of tax payable on commercial dealings. Legitimate arrangements include:

1. the adoption of ex warehouse conditions of sale which have the effect of excluding a delivery charge from the selling price of wine; and
2. the establishment of an interposed wholesale company so as to defer the payment of WET to the point of retail sale of the wine.

These and other legitimate commercial arrangements, including the adoption of indirect marketing, are discussed in recent public ruling WETR 2009/1, without any hint that their mere adoption might infringe the GAP. For example, paragraphs 104 to 110 discuss the adoption of ex-warehouse terms and their impact on WET liability. Paragraph 105 stipulates that such terms are acceptable as long as the delivery charge is "a competitive commercial charge, rather than reflecting a reduction in the price of the wine."

The implication is that any attempt to reduce the price of the wine by increasing the price of delivery would be resisted by the Tax Office, including under the GAP. This approach is entirely consistent with section 165-1 of the GST Act which states that *"This Division is aimed at artificial or contrived schemes."*

Indirect marketing sales are described in WETR 2009/1 as follows:
64. Indirect marketing sales[27] are a type of retail sale that are assessable dealings even though the purchaser of the wine may have borne wine tax. These arrangements are assessable dealings to ensure that the wine is taxed on the full wholesale value.[28] In accordance with section 5-20 there is an indirect marketing sale[29] if the sale is a retail sale by an entity which is not the manufacturer of the wine and the sale occurs in either of the following circumstances:

In relation to GST, taxpayers have been allowed to adopt contractual arrangements that achieve a cost-effective outcome for them or their customers. Two examples are GSTD 2002/3 which explains the calculation of GST on supplies of goods and delivery services according to the conditions of sale and GSTR 2004/1 which at paragraphs 319 to 336 explains that by appointing a financial supply facilitator (instead of doing the work itself), a taxpayer can become eligible for reduced credit acquisitions.

On the introduction of the indirect marketing provisions in 1985, in the then Treasurer's second reading speech, it was clear that the provisions were designed both to cater for 'avoidance' arrangements and for commercial arrangements alike. In other words, the indirect marketing provision is a de facto specific anti-avoidance provision, albeit one which targets legitimate commercial arrangements also. That being the case, it would be curious as to why a general anti-avoidance provision would ever be needed to override the specific anti-avoidance provision.

The professional bodies believe that as a general principle the adoption of commercial arrangements that are recognised by and provided for in the GST and/or WET Acts should not be the subject of compliance action under the GAP. The mere fact that a taxpayer chooses to adopt one form of commercial arrangement instead of another, or to change from one form of arrangement to another, should not be regarded as an indirect tax avoidance scheme. This is further supported by case law authorities. For example, in *Commissioner of Taxation v Hart [2004] HCA 26* Gleeson CJ and McHugh J gave an example of a taxpayer wanting to obtain the right to occupy premises in order to carry on a business enterprise deciding to lease real estate rather than buying it. The potential deductibility of the rent may be an important factor in the decision, however, if there is nothing more to it than that, it would ordinarily be impossible to conclude that the dominant purpose of the lessee in leasing the land is to obtain a tax benefit.

If such behavior is to be regarded as a scheme, the Commissioner should publish clear guidelines regarding the hallmarks of an indirect tax scheme so that taxpayers will be in a position

to structure their commercial arrangements in full knowledge of the Commissioner's likely attitude.

In this regard it is the view of the professional bodies that in dealings involving GST and/or WET, a contrived, artificial or unnecessary step or feature should be present before the GAP will be considered. This view is consistent with section 165-1 of the GST Act, quoted above. It is also supported in an income tax context by the High Court authorities such as Hart's case and *Federal Commissioner of Taxation v Spotless Services Ltd [1996] HCA 34*. Furthermore, we are aware that the ATO holds strong views that in applying Part IVA, you should have regard to the predication test in the old Privy Council in *Newton v FC of T (1958) 98 CLR 2*. Broadly, what the predication test says is that in order for a transaction to be caught by the general anti-avoidance rule, you need to be able to predicate, by looking at the overt acts by which it was implemented, and that it was implemented in that particular way so as to avoid tax. If you cannot so predicate but have to acknowledge that the transaction was capable of explanation by reference to ordinary business or family dealings, without necessarily being labeled as a means to avoid tax, then the arrangement is not caught by the general anti-avoidance rule.

The professional bodies also consider that if the GAP is to be used, it should be used to challenge the participants in an alleged scheme (or their associates). Indirect taxes are designed to be passed on in prices. Similarly, reductions in indirect taxes are designed to result in lower prices. Accordingly, we strongly disagree with the approach taken in the draft determination which foreshadows mounting an attack on arm's length suppliers who have unwittingly sold wine to a participant in an alleged scheme and received no economic benefit from any reduction in WET.

It is not uncommon for retailers to nominate a wholesale company to purchase wine for resale to the retailer. Prices may be negotiated between supplier and retailer and the wine may be delivered to the retailer's stores, but sold to the nominated wholesaler. These arrangements have always been acceptable to the Tax Office, as long as WET is paid on an arm's length wholesale price equivalent.

Therefore, when a retailer approaches a supplier and negotiates prices, delivery arrangements, volumes, invoicing and payment terms, and nominates a purchasing entity, the supplier is in no position to ascertain whether the retailer is purchasing through an interposed wholesaler or whether indirect marketing arrangements have been implemented, legitimately or otherwise.

Paragraphs 7, 8 and 20 of the draft determination identify several factors which suggest that the Tax Office has identified various elements of artificiality in the arrangements in question. We wish to make the following comments in relation to these elements:

1. The suppliers are not necessarily aware of the arrangements made between the marketer and the retailer and even if they are, do not know whether or not the additional step (of involving a marketer or wholesale company) is 'unnecessary'.
2. If there is a scheme it involves the marketer and the retailer.
3. If a GST benefit for the purposes of the GAP (i.e. a reduction in WET) is derived from participation in a scheme, none of the GST benefit is retained by the suppliers. It is either retained by the marketer and the retailer or passed on to consumers in the form of lower prices.

Having regard to the factors identified in paragraphs 7, 8 and 20 and the role played by the suppliers, we are extremely disappointed that the Commissioner would contemplate an attack on the suppliers and not on the marketer or the retailer.

SPECIFIC COMMENTS

Purpose or Effect

Section 165-15 supports our view that in relation to indirect taxes, such as WET, the GAP should only be applied to scheme participants and their associates. Section 165-15 requires detailed consideration of an entity's purpose in entering into or carrying out a scheme, and in ascertaining the effect of the scheme.

Most of the matters listed in the section require in-depth knowledge of the workings of the scheme and its impacts and assume that the "avoider" (as the entity which derives the GST benefit is described) or a "connected entity" will be in a position to defend an action by the Commissioner under the GAP.

As the suppliers are unrelated to the marketer and retailer and have no influence or control over them, it would seem incomprehensible that a supplier who is neither a participant in nor beneficiary of a scheme would be required to pay WET and a shortfall penalty following an action under the GAP.

We are at a loss to understand how a supplier could possibly hope to defend itself against a declaration under section 165-40 of the GST Act in circumstances where it is not a participant or beneficiary in an alleged scheme. The professional bodies consider that applying the GAP in these circumstances would be unjust.

In *Commissioner of Taxation v Hart (2004) HCA 26*, Gummow and Hayne JJ of the High Court discussed in an income tax context the importance of identifying the scheme, commencing at paragraphs 48. At paragraph 56, they conclude:

"The central question then becomes, would it be concluded, having regard to the eight matters listed in s 177D(b), that a person who entered into or carried out the wider scheme, the narrower scheme, or any part of either scheme, did so for the dominant purpose of enabling the respondents to obtain a tax benefit in connection with the scheme?"

Returning to the draft determination, the scheme is identified, correctly in our view, as comprising the retail sale of wine through an agent and also the interposition of the marketer between the supplier and the retailer. These are arrangements with which the supplier has no involvement.

It is clear therefore that the suppliers are not participants in a wider scheme, narrower scheme or part of a scheme. Even if the supplier sold the wine to the marketer WET paid, the marketer would be liable for WET on the half retail price method in accordance with AD2d and AD12d in the WET Act and would be entitled to a credit of the WET included in the purchase price of the wine in accordance with credit ground CR4 in section 17-5.

It should also be noted that the use of the half retail price method is a legislative safe harbour. It is intended to establish an acceptable notional wholesale value when indirect marketing sales are made. It should no more be compared the supplier's wholesale price as should the WET paid under ex warehouse terms be compared with the WET paid when goods are sold for a 'delivered price'. Differences between amounts of WET payable are not evidence of a scheme to which the GAP applies.

Under section 9-25 of the WET Act the marketer can choose to pay WET on either the half retail price method or the weighted average wholesale price. The fact that the marketer is entitled to choose between two methods regardless of which one ultimately produces the higher WET amount suggests that the policy is not to maximise the revenue; instead, it suggests that the policy is to make taxpayer compliance easier and more certain.

GST benefit?

As the supplier's sale is not part of the scheme identified in the draft determination, the professional bodies submit that the supplier gets no benefit for the purposes of section 165-10. The supplier's involvement with the wine is finished before the scheme is entered into. In saying this, we accept that the GAP is sufficiently wide to cover an entity getting a benefit from a scheme without directly participating in the scheme. However, we maintain that there should be a relevant connection between the scheme and the beneficiary of the scheme before the GAP can be applied in an indirect tax context.

Further support for this proposition can be found in section 165-5(1)(b) of the GST Act which relevantly provides that the GAP only operates if the GST benefit is not attributable to the making of a choice, election, application or agreement that is expressly provided by the wine tax law.

According to paragraphs 17 and 18 of the draft determination the GST benefit is attributable (in fact, directly attributable) to the ABN quotation provided to the supplier by the marketer. As this quotation is a choice made by the marketer pursuant to section 13-5(1)(a) of the WET Act, we consider that Division 165 cannot apply.

Section 165-5(3), which became effective on 9 December 2008, provides that a GST benefit that the "avoider" got is not taken to be attributable to a choice, election etc, if the scheme was entered into for the sole or dominant purpose of creating a state of affairs which enables the choice, election to be made.

Section 165-5(3) requires the scheme to have been entered into to create the choice to quote, thereby creating a GST benefit. However, the scheme does not depend to any extent on the quotation of an ABN by the marketer to the supplier. The scheme depends on selling wine by indirect marketing. It could operate whether the marketer purchased the wine WET-free or WET paid.

As the GST benefit received by the supplier is attributable to the ABN quotation and not to the scheme itself, the professional bodies believe that the GAP cannot apply to the scheme identified in the draft determination.

Misguided application of GAP

It is possible to identify two potential WET benefits in the arrangements, namely:

1. the difference between the WET paid by the supplier pre-scheme (29% of the wholesale price) and post-scheme('nil'); and
2. the difference between the WET paid on the wholesale price pre-scheme and the WET paid on the half retail price method.

While the Commissioner's interest appears to have been aroused by benefit number 2. above, his attack is directed at recovering benefit no. 1. This appears to be a misguided application of the GAP and is likely to fail for the reasons outlined above.

If further support for our suggestion is required, we note that the Commissioner will be required either to seek to collect double taxation on the same wine – something which is directly contrary to the scheme of the WET Act – or to refund the WET collected from the marketer once he collects the GST benefit from the supplier.

Taking the former course is contrary to the legislative policy and taking the latter course would be an absurd outcome, notwithstanding that it might be permitted under a literal interpretation of section 165-45 of the GST Act. Interpreted literally, this section might permit the marketer to be treated as the "loser", i.e. someone whose liability for WET was higher than it would have been if there had been no scheme. To compensate a marketer in these circumstances would be a ludicrous outcome.

CONCLUSION

The professional bodies consider that the adoption of indirect marketing arrangements is not a scheme for the purposes of the GAP. To the extent that they were once regarded as avoidance, the legislative policy is that as long as WET is paid on half the retail price, the arrangements comply with the WET Act.

Where contrived or artificial features are combined with any form of arrangement, the professional bodies consider that the GAP may apply. Where it applies, it should be applied against the scheme participants or their associates who obtain the benefit of the reduced amount of WET payable and not against unrelated third parties who do not benefit from the scheme.

Before a decision to issue a public ruling on the application of the GAP is taken, an escalation procedure involving referral to the Tax Counsel Network and the General Anti-Avoidance Rules Panel, as detailed in practice statement PS LA 2005/24, should be followed. As part of these procedures, the professional bodies anticipate that interested parties will be given the opportunity to make representations to the Panel.